



David B. Wescoe
Administrator/CEO

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OCT 31 2008
COUNCILMEMBER
DONNA FRYE

October 29, 2008

Councilmember Donna Frye
Sixth District
City of San Diego
202 C Street, 10th Floor
San Diego, CA 92101

Re: Your October 16, 2008 Memorandum concerning "SDCERS Investment Strategies and Potential Losses"

Dear Councilmember Frye:

Your October 16 Memorandum asked me:

- to confirm that "SDCERS securities-lent assets were not invested in any such aggressive mortgage assets or, if they were, what amounts were invested and a complete accounting of such holdings."

The October 11, 2008 Wall Street Journal article included with your Memorandum refers to State Street Corporation's investment management group, State Street Global Advisors or SSgA. SSgA provides investors with various commingled investment stock and bond funds that participate in the State Street securities lending program. SDCERS does not use these SSgA investment options.

AIG lent securities on their own behalf and did not use the services of an agent lender or independent fiduciary like State Street. SDCERS has no exposure to AIG's securities lending program.

- to "provide a written report on the SDCERS 'securities lending program,' and how this new State Street Bank policy will effect SDCERS assets and the City's pension system."

SDCERS custodies its assets with State Street Bank and Trust Company, and State Street, on an agency basis, provides securities lending services on behalf of SDCERS. Loaned securities are collateralized with cash or highly-rated securities by the borrower at 102% to 105% of the securities' market values. The borrower's collateral is held and managed by State Street in a collateral investment pool. For the fiscal year ending June 30, 2008, SDCERS received net income of \$5.3 million from this program.

The investment restrictions mentioned in the Journal article pertained to withdrawal restrictions imposed by SSgA on investors in its commingled investment portfolios. SDCERS does not invest in these portfolios. Therefore, these restrictions have no impact on

SDCERS' assets, but they do protect the interests of long-term institutional securities lending program participants such as SDCERS by reducing withdrawal transaction activity.

Three reports detailing SDCERS' securities lending program are enclosed.

- *"if any of these assets have been moved to any other depository."*

They haven't.

- *"what are the most recent mark-to-market losses, if any, in the SDCERS portfolio, particularly in the fixed income portfolio, and how are those losses reflected?"*

SDCERS has a well-established process of reviewing each fiscal year's investment progress on a quarterly basis. The most recent published report is as of June 30, 2008, and it shows the market value changes and performance in SDCERS' total fund and our various asset categories. The asset values and return rates in these quarterly reports represent full mark-to-market valuations and are not subject to any form of actuarial smoothing. The *Asset Distribution Across Investment Managers* section in this report details the market value of assets by class for the quarter ending June 30, 2008 (copy enclosed) is their report. The full report is available on our website at www.sdcers.org/investments, and an executive summary of the report was forwarded to you in August.

The report for the quarter ending September 30, 2008 will be available in mid-November. Given current market conditions, I am sure this report will show a decline from June 30th in the market value of SDCERS' assets. The unaudited and unreconciled market valuation as of October 2, which was included in Doug McCalla's Staff Report to SDCERS' Investment Committee, dated October 3, 2008, showed net assets at \$4.220 billion. The quarterly report covering market activity from October 1 through December 31, 2008 will be available in mid-February 2009.

It is important to keep in mind – and to keep current events in proper perspective - that it is the fiscal year's investment return (as of June 30) that SDCERS' actuary uses to determine the City's Annually Required Contribution (ARC). The ARC that the City will pay for the fiscal year beginning on July 1, 2009 will be based on last fiscal year's investment returns (July 1, 2007 through June 30, 2008). The market downturn from July 1 through September 30, 2008 reflects only one quarter of SDCERS' four-quarter 2009 fiscal year. Only when all four fiscal quarters have been concluded on June 30, 2009 and the ARC payment calculated, will the impact of the current market condition on the City be known. Once calculated, that ARC will not be paid by the City until the following fiscal year, beginning in July 2010.

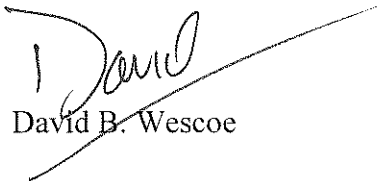
Councilmember Donna Frye

October 29, 2008

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I hope this is responsive to your questions. Thank you for your continued interest in SDCERS.

Sincerely,

A handwritten signature in dark ink, appearing to read "David B. Wescoe", is written over a horizontal line.

David B. Wescoe

Cc: Honorable Mayor Jerry Sanders
Honorable City Councilmembers
Andrea Tevlin, Independent Budget Analyst
Stanley Keller, Independent Monitor

Encl. State Street Securities Lending Program Review, September 14, 2006
Letter, dated November 14, 2006, from State Street to Douglas McCalla
Callan Associates Securities Lending Comments, November 16, 2008
Asset Distribution Across Investment Managers, from Callan Associates'
June 30, 2008 Quarterly Review

STATE STREET

Board of Administration for the San Diego City Employees' Retirement System

Securities Lending Program Review

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COUNCIL MEMBER
DONNA FRYE

Date: September 14, 2006

By: John P. McGuire

Agenda

- Securities Lending Overview
- Relationship Highlights
- Performance & Return

Securities Lending Overview

➤ What is Securities Lending?

- The temporary transfer of idle securities within a portfolio to a borrower for a fee in a fully collateralized transaction.

➤ Who are the Players?

- Central banks, mutual funds, pension funds, insurance companies, endowments, corporations, banks, asset managers, hedge funds.

➤ What are the Benefits?

- Lender – a low risk means to enhance returns by utilizing otherwise dormant securities.
- Borrower – lending provides for the availability of securities needed to engage in trading strategies

Securities Lending Overview

Why are Securities Borrowed?

➤ Trade Settlement

- Securities are borrowed by a counterparty who has a commitment to deliver shares that it has sold but does not possess
- Borrowing of shares facilitates trade settlement, decreasing failed trades
- Market-makers and exchange specialists borrow to facilitate an orderly market in their stocks

➤ Short sales

- A short position in a stock or bond is created by borrowing and selling the shares; it is subsequently covered by buying the shares and returning them
- Hedged trading strategies involve paired long and short positions that attempt to neutralize a certain risk

➤ Tax arbitrage

- Foreign securities are loaned to borrowers to take advantage of differing tax structures.

➤ Price Arbitrage

- Arbitrage traders borrow shares to take advantage of price discrepancies in various markets

➤ Merger Arbitrage

Securities Lending Overview

Borrower Strategies

➤ Hedge funds engage in trading strategies that involve short positions

- Hedged trading strategies involve paired long and short positions that attempt to neutralize a certain risk.
- Arbitrage trading strategies; i.e. merger (risk), convertible, index; are facilitated

➤ **Securities are borrowed as part of a financing strategy**

- Small dealer inventory positions can be financed through a non-cash collateralized lending transaction
- U.S. government or agency securities are borrowed as an extension of the repurchase agreement market

Securities Lending Overview

Lender Strategies

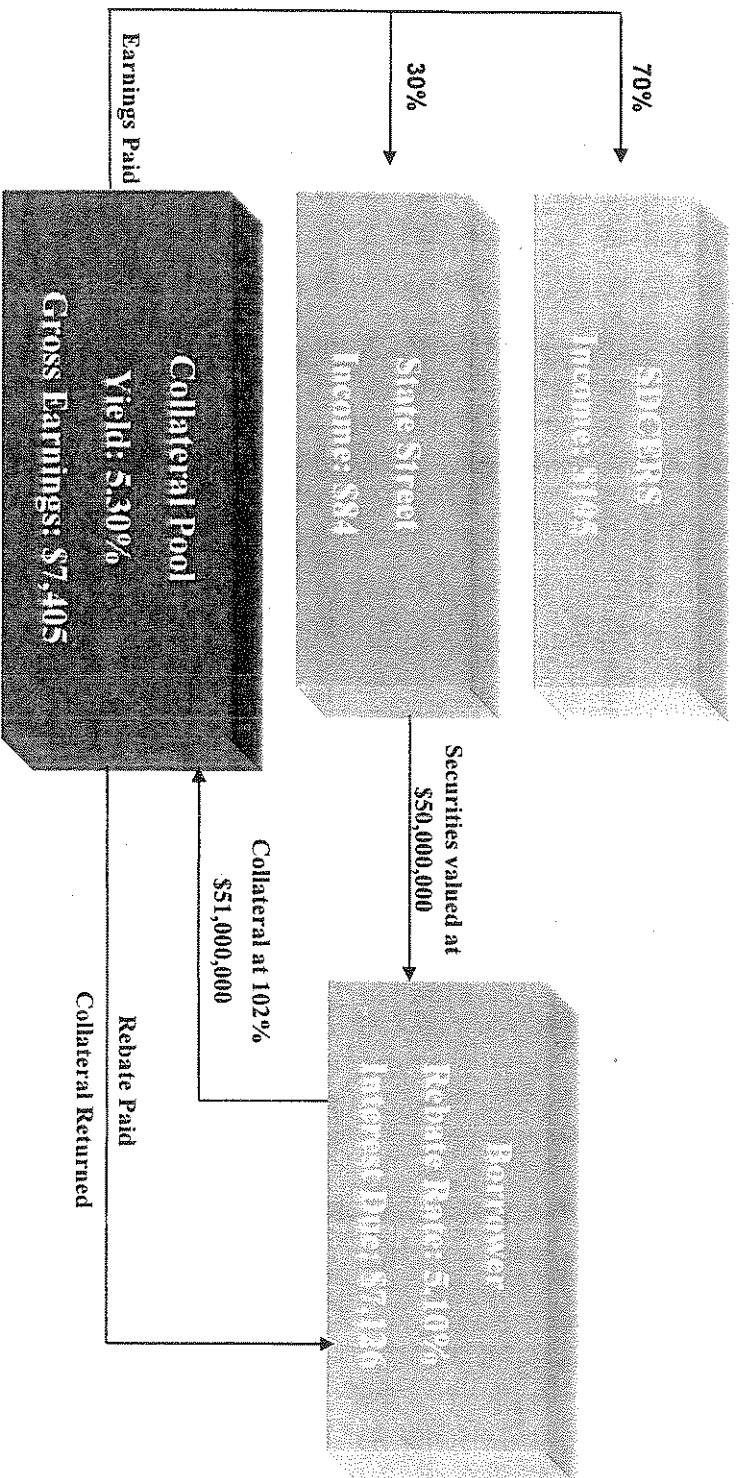
➤ Lender Motivations

- Greater utilization of otherwise dormant securities
- Low risk method to enhance returns
- Off set custody fees
- Transparent to investment managers

➤ Future growth

- As emerging markets continue to become favorable to a wider array of financing and capital market activity securities lending continues to achieve robust growth
- Of 80 markets which we service custody clients, only half currently support lending activity.

A Typical Transaction



Securities Finance Overview

Risk Management

➤ Counterparty Default Risk

- State Street indemnification
- Counterparty selection and review
- Daily exposure monitoring
- Collateral maintenance

➤ Collateral Management/Investment Risk

- Seasoned portfolio management team
- Independent credit policy & research team
- Multiple reinvestment options

➤ Operational Risk

- 40%+ of staff allocated to operational functions
- Leverage technology where possible

➤ Asset/Liability Risk

- Coordination between trading and reinvestment functions
- Stress testing of interest rate scenarios

➤ Legal/Regulatory Risk

- Dedicated legal & product development teams

Relationship Highlights

- Entered Securities Lending program in March, 1998
- Cash Collateral managed by SSgA (GCM):
 - Quality D/SSGSLET
- Acceptable collateral types include:
 - Cash (US and foreign currency)
 - Securities issued or guaranteed by the US Government
 - Letters of Credit
- Indemnified against borrower default
- Fee Split
 - 75/25 for US Corp and US Govt., 70/30 for IE & IF
- Plan Details
 - Cap % should not be set to more than 95%.
 - Must have 1000 shares of anything in a fund at all times.
 - Fund gHIZ – Rogge International Bonds is set-up for EUR cash.

Performance Review

City of San Diego		2004	2005	YTD June, 30, 2006
Average Lendables (\$)		2,047,386,343	2,289,804,107	2,547,822,355
Average Collateral Balance (\$)		319,217,289	407,898,553	541,009,325
Average On Loan Balance (\$)		309,499,881	395,920,992	523,592,237
Earnings by Program				
US Government (\$)		312,826	508,470	165,068
US Corporate (\$)		107,847	162,569	50,814
Non US Equity (\$)		408,861	438,566	246,685
Non US Fixed (\$)		5,257	26,203	11,016
Total (\$)		834,791	1,135,809	473,582
Components of Spread				
Demand Spread (bps)		23	25	27
Reinvestment Spread (bps)		13	13	13
Net Spread (bps)		36	38	40

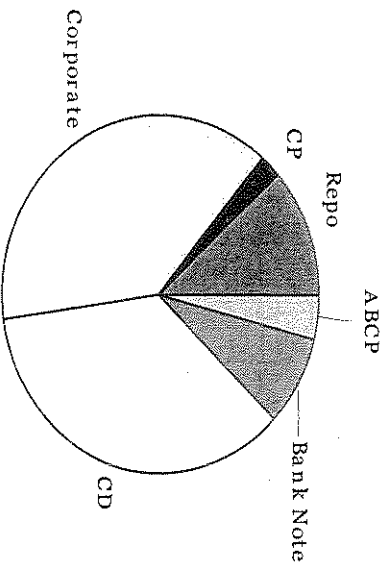
Security	Earnings
DEUTSCHE TELEKOM NPV (REGD)	16,350
UNITED STATES TREAS NTS INTR: 4.25 MATD: 11/15/14	13,335
FRANCE TELECOM EUR4	12,944
UNITED STATES TREAS NTS INTR: 4.25 MATD: 11/15/14	12,111
UNICREDITO ITALIAN EURO.50	8,994
DEUTSCHE TELEKOM NPV (REGD)	8,477
FAIRFAX FINL. HLDGS LTD SR NT INTR: 7.75 MATD: 04/26/12	8,296
UNITED STATES TREAS NTS INTR: 4.25 MATD: 11/15/14	7,949
GAZPROM O A O SPONSORED ADR REGS 43	7,842
DAIMLERCHRYSLER AG ORD NPV (REGD)	7,774

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Global Collateral Management Quality D

31-Jul-06	QUALITY D
1-Day Net Yield (360 Basis)	5.30%
Shares Outstanding	78,775,079,746.52
Floating Rate %	64.43
% Foreign Issuers	45.03
WAM	51.68
WAM to Call	51.68
Call v. Mat Spread	-
% Callables	0.00%
Avg Life-Expected Maturity	476.04
Credit Score	0.8907

LONG-TERM RATINGS	% OF FUND
AAA	3.11
AA	16.58
A	14.65
BBB	-
SHORT-TERM RATINGS	% OF FUND
A-1+/P-1	33.21
A-1-/P-1	32.45
SPLIT	-
OTHER	-



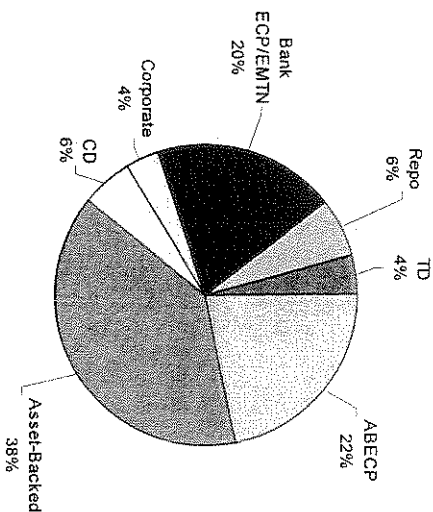
FED FUNDS	% OF FUND
1MO LIBOR	0.16
3 MOS LIBOR	25.20
PRIME	39.07
-	-
FLOATING RATE RESET BUCKETS	% OF FUND
Next Business Day	1.34
2-7 Days	1.68
8-31 Days	30.16
1-2 Months	18.42
2-3 Months	12.87
% MAT BY FOMC DATES	% OF FUND
Next Business Day	8.14
To 8/8	5.11
From 8/8 to 9/20	7.28
From 9/20 to 10/24	7.07
From 10/24 to 12/12	5.11
From 12/12 to 1/31	4.60
From 1/31 to 3/27/07	5.10
From 3/27/07 to 5/10/2007	3.49
From 5/10	54.11

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Global Collateral Management Euro Trust

18-Apr-06	
1-Day Net Yield (365 Basis)	2.69%
Par Amount	9,493,950,000
Floating Rate %	51.89
WAM	34.35
% Callables	0.00%
Avg life - Final Maturity	4.61

LONG-TERM RATINGS (S&P)	% OF FUND
AAA	33.90
AA	10.87
A	12.34
BBB	-
SHORT-TERM RATINGS (S&P)	% OF FUND
A-1 +	28.54
A-1	14.35
OTHER	-



INDEX BREAKDOWN	% OF FUND
EONIA	-
1 MOS Euribor	11.00
3 MOS Euribor	40.69
6 MOS Euribor	0.20
SEC Days BUCKETS	% OF FUND
Next Business Day	6.39
4/20/2006 to 5/4/2006	25.13
5/5/2006 to 6/8/2006	35.91
6/9/2006 to 7/6/2006	17.03
after 7/7/2006	15.54
% MAT	% OF FUND
Next Business Day	6.32
4/20/2006 to 5/4/2006	14.03
5/5/2006 to 6/8/2006	21.50
6/9/2006 to 7/6/2006	4.10
after 7/7/2006	54.05

Biography

John P. McGuire

Assistant Vice President,
Account Management, Securities Finance, State Street

John is an assistant vice president and relationship manager in State Street's Securities Finance division. In this role, John is responsible for ensuring overall service delivery and client satisfaction for his U.S. lending clients. He also acts as the single point of contact and advocate for Securities Finance-related matters for his clients.

Prior to his current role, John worked on the money market desk within State Street Global Markets. John was responsible for trading short-term fixed income instruments, establishing new relationships and servicing existing clients. John has also served as an account manager in State Street Capital Markets and in Investor Services.

John holds an M.B.A. from Boston University and a B.A. from Lehigh University. He holds the General Securities Representative (Series 7) and State Uniform Securities Agent (Series 63).



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COUNCILMEMBER
DONNA FRYE

Mr. Douglas McCalla
Chief Investment Officer
San Diego City Employees' Retirement System
401 B Street – Suite 2210
San Diego, CA 92101

November 14, 2006

Dear Doug,

On September 14 State Street Securities Finance was asked to appear before the Investment Committee of SDCERS to present an overview of the securities lending program. During this review State Street and SDCERS board members engaged in a meaningful discussion that encompassed all areas within securities lending.

Following the State Street presentation the board had additional questions surrounding the lending program and requested State Street to provide commentary. In conjunction with Doug McCalla, State Street reviewed the SDCERS board's transcript and developed the attached write up.

The intention of the write up is to address questions raised by the board and provide a clear and concise document that addresses the risks surrounding securities lending. The document also clarifies how State Street's industry leading systems, controls and personnel provide SDCERS with a low risk method to achieve incremental returns on its portfolio.

The purpose of the November 16 meeting is to review any outstanding questions the board may have regarding securities lending as well as to introduce senior members of the State Street Securities Finance group including Suzanne Lee, Senior Managing Director, Head of North American Account Management and Glenn Horner, Managing Director, Portfolio Strategy and Quantitative Modeling (biographies are attached).

As a critical part of our capital markets, securities lending provides vital liquidity and facilitates economic growth, leading to its support and use by the SEC, the Federal Reserve, and many major central banks from around the world. Securities lending has long been a valuable tool for institutional investors, including US public pension funds, to achieve pure incremental alpha as well as to offset the myriad expenses of administering the plans.

State Street currently provides lending services to 98 US public pension funds, containing more than \$600 billion in assets.

Regards,
John McGuire



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**State Street Securities Finance
Securities Lending Program
Questions for San Diego City Employees' Retirement System
November 16, 2006**

Biographies

SUZANNE N. LEE
Senior Managing Director
Head of North American Account Management, Information Delivery and Marketing
Securities Finance
State Street

Suzanne N. Lee, senior managing director, is the head of North American account management, information delivery and marketing for State Street's Securities Finance division. In this role she is responsible for the division's client relationships in North America, its global marketing communications initiatives, and global product management of online reporting and analysis tools including SL PerformanceReporter® and SL PerformanceAnalyzer®.

Ms. Lee previously was head of client services in State Street's Global Markets division, where she was responsible for client relationships for the transition management and commission recapture businesses in the U.S. From 1991–1999 she held key roles in both trading and client service in the securities finance business, working with accounts in the U.S. and Canada.

Ms. Lee joined State Street in 1989 as a portfolio accountant in the Master Trust division. She holds a B.A. in economics from Stonehill College and is Series 7, 63 and 24 licensed.

State Street lends securities and provides liquidity in more than 35 markets worldwide via securities finance offices and trading desks located throughout North America, Europe, and the Asia/Pacific region.

GLENN HORNER, CFA, F.R.M.
Managing Director
Portfolio Strategy and Quantitative Modeling
Securities Finance
State Street

Glenn Horner, managing director, manages the portfolio strategy and quantitative modeling department for State Street's Securities Finance division. Mr. Horner's responsibilities include the oversight of the asset and liability structure of clients' lending and reinvestment portfolios, responsibility for the global management of the borrower credit risk function, and the supervision of research and development of new risk methodologies for quantitative products.



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Questions for San Diego City Employees' Retirement System
November 16, 2006**

Mr. Horner joined the company in 1990 and has held various risk management-related positions, including risk analyst, asset-liability manager, and risk management consultant for institutional investors as part of State Street's former Askari subsidiary.

Mr. Horner holds a B.S. from Babson College and an M.B.A. from the Olin Graduate School of Business at Babson College. He has also been awarded the Chartered Financial Analyst (CFA) designation, the Global Association of Risk Professionals' Financial Risk Management (F.R.M.) certification, and the Professional Risk Managers' International Association's Certified Risk Manager designation. He is a member of the Association for Investment Management and Research, the Global Association of Risk Professionals, the Boston Security Analysts Society, and the Professional Risk Managers' International Association.

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**John P. McGuire
Assistant Vice President, Account Management
Securities Finance, State Street**

John is an assistant vice president and relationship manager in State Street's Securities Finance division. In this role, John is responsible for ensuring overall service delivery and client satisfaction for his U.S. lending clients. He also acts as the single point of contact and advocate for Securities Finance-related matters for his clients.

Prior to his current role, John worked on the money market desk within State Street Global Markets. John was responsible for trading short-term fixed income instruments, establishing new relationships and servicing existing clients. John has also served as an account manager in State Street Capital Markets and in Investor Services.

John holds an M.B.A. from Boston University and a B.A. from Lehigh University. He holds the General Securities Representative (Series 7) and State Uniform Securities Agent (Series 63).

{Attachment}



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**State Street Securities Finance
Securities Lending Program
Questions for San Diego City Employees' Retirement System
November 16, 2006**

State Street Lending Philosophy

State Street is one of the most experienced securities lending organizations serving the market today. As such, it has developed industry leading risk management tools, while at the same time achieving significant returns for our clients.

Securities Lending is a core business for State Street, we have invested significantly in our human and operational resources to make sure that we continue to be the leader of the lending industry. Our worldwide team includes more than 300 professionals who manage the legal, compliance, global trading, and asset/liability management aspects of securities lending.

Securities Lending Regulation

Securities lending, which provides liquidity to financial markets, is regulated by the following agencies or central banks:

- Federal Reserve
- Securities and Exchange Commission
- Central banks and other regulatory bodies in each of the borrowing jurisdictions

How SDCERS Lends a Security

A typical transaction for SDCERS securities lending includes:

1. New loans are initiated upon request by borrowers. Collateral (102%-105% of loan value) is either received prior to, or at the same time, securities are delivered.
2. Loans may be returned either by request by State Street or voluntarily by the borrower. Securities are received prior to, or at the same time, the return of collateral.
3. Existing loans are "marked-to-market" based on the prior evening's closing price. Margin calls or returns are issued as appropriate to ensure proper collateralization is maintained.
4. In return, the lender pays interest on the cash deposit.
5. The collateral (due to new loans or marks) is invested in a collateral pool.
6. The net spread between the yield on collateral pool and interest paid to the borrower is accrued to SDCERS.

Net Benefit – SDCERS has averaged over \$1 million per year in securities lending revenue since 2000 and is on track to surpass this number in 2006



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**State Street Securities Finance
Securities Lending Program
Questions for San Diego City Employees' Retirement System
November 16, 2006**

Q: Who are the borrower's?

A: State Street lends securities to approximately 130 State Street approved governmentally regulated broker-dealers and banks. SDCERS has broad diversification among borrowers.

Borrowers are approved through the same formal credit review process through which all State Street commercial lending credit requests are approved. Trained analysts within State Street's Enterprise Risk Management division, an operating unit distinct from Securities Finance, conduct the credit review/analysis process. This separation of duties provides the necessary check-and-balance framework that is key to the management of borrower credit risk management.

Securities Finance's Risk Management area screens each prospective borrower. In addition to the traditional credit analysis process, we conduct on-site visits with management and the operating unit. Both the "credit fit" and "business fit" of the prospective borrowers are assessed through this process.

Our assessment of borrower creditworthiness and the resulting credit exposure limits are determined through traditional analysis including the following key considerations:

- Industry presence, strategic focus and diversification
- Quality and stability of earnings
- Capital adequacy/financial leverage/asset quality and liquidity
- Stability and reliability of funding (i.e., availability of external credit support)
- Credit quality of affiliated group of companies (if applicable)
- Support by parent, support provided to subsidiary
- Special arrangements (e.g., guarantees, comfort letters)
- Quality and completeness of financial reporting

Q: Does State Street lend to hedge funds?

A: No.



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**State Street Securities Finance
Securities Lending Program
Questions for San Diego City Employees' Retirement System
November 16, 2006**

Q: How are borrowers' monitored?

A: After a borrower is approved for the program, State Street's Risk Management staff monitors the credit quality of each of our approved borrowers. Formal reviews are scheduled whenever there is a change in a borrower's financial condition, or when a corporate change occurs. Our Risk Management staff frequently communicates with our borrowers' senior and executive management to gain better insight into their financial condition and business strategy. In most cases, our discussions are held with the Treasurer or Chief Financial Officer.

Securities lending credit limits are established based upon an extensive review of the borrower's creditworthiness. The credit lines approved for each borrower represent the aggregate level that State Street believes is appropriate for a particular borrower. These limits are approved and administered for each borrower in "risk equivalent" terms. The risk equivalent system allows credit to be allocated across all lending products based on the price volatility of the loaned securities relative to the collateral securing the loan. Risk management staff monitors these credit limits daily for compliance.

State Street does accommodate client requests to establish individual borrower loan limits and restrictions. Borrower restrictions are "hard coded" on our trading application by a centralized data control processing unit to ensure timely and accurate processing of program restrictions.

Q: What is the probability of a borrower default?

A: We maintain a rigorous initial and ongoing borrower credit review and have a staff of analysts dedicated to this process. In State Street's 32 years of lending there have been three borrower defaults, but due to the stringent controls in place no client losses have ever occurred due to a default situation.



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**State Street Securities Finance
Securities Lending Program
Questions for San Diego City Employees' Retirement System
November 16, 2006**

Q: How does State Street mitigate borrower default risk?

A: State Street's process to mitigate borrower default risk includes:

- Thorough credit review process of prospective borrowers by dedicated credit team; analysis includes review of qualitative (quality of management, reputation, quality of management) and quantitative (credit rating, capital base, financial statements) information
- Addition of new borrowers requires approval by divisional (Securities Finance) management and separate approval by corporate (State Street) enterprise risk management team
- Excess initial collateral of 102% for US equity and debt securities and non US debt securities; 105% for non US equity securities
- Daily mark-to-market of outstanding loans based on previous night's closing price
- Inclusion of 150+ borrowers (diversification)
- Borrower default indemnification

Q: What happens if the value of collateral liquidated does not meet the value of the security in question?

A: Through the borrower default indemnification included in our contract with SDCERS, State Street is responsible for covering any amounts between the value of collateral and cost of replacement securities.

Q: How is collateral value monitored and maintained?

A: Loans are priced daily based on industry standard pricing information. Margin calls and returns are initiated each business day to increase or decrease collateral as appropriate. Initial margin of 102% for US equity and debt and non US debt securities and 105% for non US equity securities is required.

Q: What happens if a borrower defaulted?

A: In the event of a borrower default, State Street immediately liquidates the collateral and purchases replacement securities on behalf of SDCERS. All clients have a perfected security interest in the collateral, which is maintained in segregated accounts exclusively for SDCERS.



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Q: What is borrower default indemnification?

A: Borrower default indemnification is a client guarantee that State Street will bear any cost of ensuring the availability of replacement securities in the event a borrower defaults. State Street assumes the risk of any shortfall in collateral to purchase replacement securities.

Q: Who actually issues the indemnification? State Street B&T or a subsidiary

A: State Street Bank & Trust Company, which is regulated by the Federal Reserve.

Q: How is State Street's outstanding capital monitored in relation to the outstanding indemnification?

A: State Street Bank & Trust Company must meet regulatory guidelines for being well capitalized in order to maintain its status as a financial holding company. In addition, State Street Bank & Trust Company must also meet Federal Reserve guidelines. As of June 30, 2006 State Street Bank & Trust's overall capitalization was \$5.96 billion.

Q: What happens to the cash collateral?

A: Cash collateral is invested in a commingled investment fund dedicated to our securities lending business and is managed by State Street Global Advisors (SSgA). As of November 1, 2006, the value of the fund was approximately \$89.6 billion. Investment guidelines include:

- Weighted average maturity is restricted to 120 days or less
- Maximum remaining effective maturity of variable-rate security is five years
- Maximum remaining effective maturity of fixed-rate security shall be 30 months
- Minimum credit quality for long term securities > A-
- Minimum credit quality for short term securities > A1/P1
- Permissible investments include bank notes, commercial paper, corporate debt, US government, time deposits, asset backed securities, floating rate notes and repurchase agreements



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November 16, 2006**

- Q: Can SDCERS lose money if the yield in the fund drops below the yield of an outstanding loan?
- A: Yes, negative earnings may accrue to a client if the interest on the loan exceeds the yield on the collateral. In the event this situation occurs, SDCERS and State Street will split the loss according to the current 75 / 25 fee split.

It is worth noting that SDCERS has consistently earned significant revenue generation from the securities lending program. Since 2000, SDCERS has earned an average of \$1 million per year through its participation in the lending program.

- Q: How does State Street mitigate collateral investment risk?
- A: Securities Finance's traders and asset/liability managers work closely with SSgA portfolio managers to protect against the risks associated with collateral investment and asset/liability mismatch. Together, they evaluate and negotiate the economic consequences of term trades, pending interest rate movements and anticipated changes in the loan portfolio composition, such as subscriptions, redemptions, asset re-allocation strategies, and investment updates. The lines of communication between Securities Finance and SSgA improve liquidity management, lead to enhanced returns, and reduce risks associated with the cash collateral investment portfolio. No client has ever lost money because of a default in one of SSgA's collateral reinvestment funds.



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**State Street Securities Finance
Securities Lending Program
Questions for San Diego City Employees' Retirement System
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Q: What is State Street's audit process?

A: Internal Auditors

State Street has a Corporate Audit group staffed by more than 70 professionals that report directly to the Examining and Audit Committee of the Board of Directors. Corporate Audit is charged with reviewing and evaluating the effectiveness of State Street internal controls, as well as coordinating external audits and examinations of the corporation.

Corporate Audit maintains an inventory of the auditable entities within State Street and, using a sophisticated model for analyzing the relative risks in each entity, prepares an annual audit plan for the Committee's review and approval. Individual audits are conducted following the principles outlined in the Committee of Sponsoring Organizations of the Treadway Commission (COSO) methodology, which encompasses the identification of business objectives, the risks associated with achieving the objectives and the controls management must implement to ensure that the risks are effectively managed.

External Auditors

State Street contracts with two public accounting firms – Ernst & Young and PricewaterhouseCoopers to conduct annual financial statement audits and semi-annual internal control reviews.

Ernst & Young, which has been our independent accounting firm since 1972, conducts annual audits that focus on our overall financial operation and condition. In addition, the firm attests to our compliance with Federal Deposit Insurance Corporation Improvement Act (FDICIA) Sec. 112 requirements and compliance with Sarbanes-Oxley Section 404.

PricewaterhouseCoopers prepares a Global Controls Examination of our internal control structure and procedures on a semi-annual basis covering the six-month periods ending March 31 and September 30. A formal report is prepared at the end of each audit period.

The firm has been performing these reviews since the Introduction of SAS 70 in 1993. Between 1980 and 1993, they had been performing similar services under SAS 44. We believe use of the Global Controls Examination effectively meets the needs of our clients and their external auditors.

State Street is also subject to review by the Federal Reserve Bank.

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COUNCILMEMBER
DONNA FRYE

Securities Lending Comments

Presented by



CALLIAN ASSOCIATES

Nov. 16, 2006

SecLending Performance Impact

Net Positive Performance Impact in Basis Points in Excess of the Benchmark

Passive Indexing (Median)	2005	2004	2003	2002	2001
S&P 500	1.09	0.62	0.84	1.16	1.37
S&P MidCap	3.87	3.51	4.01	5.41	7.54
Russell 1000	1.61	1.27	1.36	1.48	1.87
Russell 2000	17.03	11.58	11.81	14.65	18.14
Russell 3000	2.94	1.90	1.61	2.10	2.99
Wilshire 5000	2.24	2.20	2.56	3.52	5.64
EAFE	17.26	19.26	22.22	17.23	30.47
Passive Agg Bond	3.70	3.40	3.70	6.70	8.10



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COUNCILMEMBER
DONNA FRYE

Callan Associates Inc.
Investment Measurement Service
Quarterly Review

San Diego City Employees' Retirement System
June 30, 2008

The following report was prepared by Callan Associates Inc. ("CAI") using information from sources that include the following: fund trustee(s); fund custodian(s); investment manager(s); CAI computer software; CAI investment manager and fund sponsor database; third party data vendors; and other outside sources as directed by the client. CAI assumes no responsibility for the accuracy or completeness of the information provided, or methodologies employed, by any information providers external to CAI. Reasonable care has been taken to assure the accuracy of the CAI database and computer software. In preparing the following report, CAI has not reviewed the risks of individual security holdings or the compliance/non-compliance of individual security holdings with investment policies and guidelines of a fund sponsor, nor has it assumed any responsibility to do so. Copyright 2008 by Callan Associates Inc.

Investment Manager Asset Allocation

The table below contrasts the distribution of assets across the Fund's investment managers as of June 30, 2008, with the distribution as of March 31, 2008. The change in asset distribution is broken down into the dollar change due to Net New Investment and the dollar change due to Investment Return.

Asset Distribution Across Investment Managers

	June 30, 2008				March 31, 2008	
	Market Value	Percent	Net New Inv.	Inv. Return	Market Value	Percent
Domestic Equities	\$1,768,044,185	37.94%	\$(29,000,000)	\$5,403,052	\$1,791,641,133	38.02%
Delta Asset Mgmt.	176,334,926	3.78%	(2,400,000)	(7,003,474)	185,738,399	3.94%
INTECH	178,864,399	3.84%	0	(3,183,082)	182,047,481	3.86%
TCW Asset Mgmt.	351,272,362	7.54%	(19,000,000)	14,235,819	356,036,543	7.56%
Dodge & Cox	334,835,953	7.19%	0	(15,739,122)	350,575,075	7.44%
GlobeFlex Capital	191,349,586	4.11%	(600,000)	12,520,736	179,428,850	3.81%
TCW - Mid Cap Value	189,219,212	4.06%	(7,000,000)	7,485,385	188,733,827	4.01%
Putnam - Small Cap Growth	90,571,672	1.94%	0	2,515,429	88,056,243	1.87%
Wall Street Associates	87,781,872	1.88%	(0)	4,996,865	82,785,007	1.76%
Putnam - Small Cap Value	81,588,960	1.75%	(0)	(5,031,788)	86,620,748	1.84%
DFA - Small Cap Value	86,225,243	1.85%	0	(5,393,716)	91,618,959	1.94%
International Equity	\$820,971,088	17.62%	\$(1,124,437)	\$1,604,215	\$820,491,309	17.41%
Brandes Investment	318,770,396	6.84%	0	(5,654,265)	324,424,661	6.89%
McKinley Capital	338,666,502	7.27%	(1,000,000)	7,697,890	331,968,612	7.05%
Putnam Int'l	12,045	0.00%	(36,390)	28,930	19,505	0.00%
Globeflex International	99,650,824	2.14%	0	531,223	99,119,601	2.10%
Grantham, Mayo, Van Otterloo	63,841,446	1.37%	0	(1,011,263)	64,852,709	1.38%
Nicholas-Applegate	29,875	0.00%	(88,047)	11,699	106,222	0.00%
Domestic Fixed-Income	\$1,397,672,149	29.99%	\$(10,061,417)	\$16,782,632	\$1,390,950,935	29.52%
Met West	395,276,762	8.48%	(5,000,000)	(6,951,775)	407,228,537	8.64%
PIMCO	407,149,742	8.74%	(5,000,000)	(4,956,018)	417,105,760	8.85%
Fidelity	155,073,428	3.33%	(61,326)	14,294,525	140,840,229	2.99%
Salus Capital	154,290,344	3.31%	0	7,762,814	146,527,529	3.11%
SSI	134,743,565	2.89%	(92)	3,263,405	131,480,251	2.79%
Nicholas-Applegate	151,138,308	3.24%	0	3,369,680	147,768,628	3.14%
International Fixed	\$199,505,728	4.28%	\$0	\$(8,463,906)	\$207,969,634	4.41%
Rogge International	199,505,728	4.28%	0	(8,463,906)	207,969,634	4.41%
Real Estate	\$471,414,220	10.12%	\$0	\$(6,487,519)	\$477,901,738	10.14%
California Smart Growth IV*	6,123,925	0.13%	0	0	6,123,925	0.13%
Capmark*	7,714,122	0.17%	0	0	7,714,122	0.16%
Cornerstone*	15,450,564	0.33%	0	0	15,450,564	0.33%
Cornerstone Apartment Venture III*	2,879,955	0.06%	0	0	2,879,955	0.06%
INVESCO*	58,345,585	1.25%	0	0	58,345,585	1.24%
INVESCO Enhanced*	29,049,805	0.62%	0	0	29,049,805	0.62%
INVESCO Enhanced II*	3,026,624	0.06%	0	0	3,026,624	0.06%
RREEF Funds*	220,253,821	4.73%	0	0	220,253,821	4.67%
Colony Investors VIII*	9,322,578	0.20%	0	0	9,322,578	0.20%
Fidelity Real Estate Growth III*	700,780	0.02%	0	0	700,780	0.01%
RREEF REITs	118,546,461	2.54%	0	(6,487,519)	125,033,979	2.65%
Securities Lending	-	-	\$(1,694,725)	\$1,694,725	-	-
Cash Account	\$2,252,797	0.05%	\$(20,852,265)	\$79,847	\$23,025,214	0.49%
Total Fund	\$4,659,860,166	100.0%	\$(62,732,844)	\$10,613,046	\$4,711,979,964	100.0%

* Current quarter's valuation is not available; 03/31/2008 valuation, provided by SDCERS' Real Estate Consultant, is used.